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DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 01-0347
Income
For Tax Years 1995-98

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ISSUES

I. Gross Income Tax—Partnership Distributions

Authority: First National Leasing and Financial Corp. v. Indiana Department of State Revenue, 598 N.E.2d 640 (Ind. Tax 1992); 45 IAC 1.1-1-3; 45 IAC 1.1-2-13; Black's Law Dictionary, 6th Ed., 928 (West Publishing 1990)

Taxpayer protests imposition of gross income tax on partnership distributions.

II. Tax Administration—Non-Filing Penalty

Authority: IC 6-8.1-10-3

Taxpayer protests imposition of a twenty percent (20%) non-filing penalty.

STATEMENT OF FACTS

Taxpayer is a limited partner in a cable television company doing business in Indiana. As the result of an audit, the Indiana Department of State Revenue ("Department") issued proposed assessments for income tax for the tax years 1995 through 1998. Taxpayer disagreed with the proposed assessments and filed a protest. Further facts will be supplied as required.

I. Gross Income Tax—Partnership Distributions

DISCUSSION

Taxpayer protests the proposed gross income tax assessments for the tax years 1995 through 1998. The Department issued the proposed assessments based on income taxpayer received as partnership distributions. Taxpayer states that it had no business situs in Indiana and therefore could not be subject to gross income tax.

In support of its position that taxpayer did have an Indiana business situs, the Department refers to 45 IAC 1.1-1-3, which states in relevant part:

> (a) A "business situs" arises where possession and control of a property right have been localized in some business or investment activity away from the owner's domicile.
> (b) A taxpayer may establish a business situs in ways, including, but not limited to, the following:
> …
> (7) Ownership (in whole or part) of a partnership doing business in Indiana unless the ownership is that of a limited partner who does not participate in the control of the business.
> ….

In the audit report, the Department notes that taxpayer's corporate officers are the same corporate officers of the general partner and both other limited partners, and that these officers are also officers of the parent corporation which indirectly owns one hundred percent (100%) of the partnership.

The Department states in the audit report that taxpayer does not meet the definition of a limited partner, without providing a citation for the definition. The Department further states that taxpayer acquired the limited partnership interest from an affiliated corporation on paper only. Taxpayer's federal balance sheet as reported on its federal return shows that taxpayer has never had a bank account or owned any assets to invest in return for a partnership interest. The balance sheets on the federal return have never shown any balances in any asset, liability or capital accounts. Taxpayer's asset accounts on the balance sheet have never reflected the ownership of the partnership interest or any of the distributive share of the partnership's income in the taxpayer's capital account.

Taxpayer objects that this is due to errors in record keeping and that no definition for a limited partner appears in Indiana statutes, regulations, or case law. Taxpayer also states that the only place it could find any definition of "limited partner" was in an audit-gram dated after the audit period, and that even if it were to accept this definition, which it does not, the Department could not retroactively impose this definition on taxpayer. While the audit report does not provide a citation for the definition of "limited partner", such a definition is found in Black's Law Dictionary, which defines a "limited partner" as:

> A person who has been admitted to a limited partnership as a limited partner in accordance with the partnership agreement. Uniform Partnership Act, § 101. A partner whose liability to third party creditors of the partnership is limited to the amount invested by such partner in the partnership.
>
> Black's Law Dictionary, 6th Ed., 928 (West Publishing 1990)

Also, a "Limited Partnership" is defined as:

> Type of partnership comprised of one or more general partners who manage business and who are personally liable for partnership debts, and one or more limited partners who contribute capital and share in profits but who take no part in running business and incur no liability with respect to partnership obligations beyond contribution.
>
> Id.

As explained in the audit report, there was no amount invested by taxpayer for its share of the partnership. As explained in Black's, a "limited partnership" has limited partners who contribute capital. Taxpayer has not demonstrated that it contributed any form of capital. Therefore, taxpayer does not qualify as a limited partner, and 45 IAC 1.1-1-3(b)(7) provides that partnership interests qualify as a business situs. Also, taxpayer has not established that it does not participate in the control of the business.

Taxpayer also refers to First National Leasing and Financial Corp. v. Indiana Department of State Revenue, 598 N.E.2d 640 (Ind. Tax 1992). In that case, First National Leasing leased train derailment equipment to Hulcher Corporation, a wholly owned subsidiary. The equipment was used to place railroad cars and locomotives back on the tracks after a derailment. The lessee had a base in Indiana at which it stored some of the leased equipment. The Court decided that the taxpayer did not owe Indiana income tax on the income from the leases in that case because First National Leasing (taxpayer-lessor) had no control over the equipment. As the Court explained:

> The sole activity First National has in Indiana is ownership of equipment that is located in Bluffton independently of any direction, consent, or, often times, knowledge of First National. The critical transaction in this case is the leasing of property. First National executed its leases in Illinois and Texas, not Indiana. The leases were not negotiated in Indiana; and the lease payments are not made or received in Indiana. Consequently, none of First National's activities related to the lease contract itself are conducted in Indiana.
>
> Id., at 644-5.

Regarding whether or not First National had a business situs in Indiana, the Court in First National Leasing explained:

> Consequently, although First National owns the equipment that Hulcher leases, locates, and uses in Indiana and elsewhere, the activities related to the lease formation and execution and the purpose of the lease, the use and possession of the equipment are overwhelmingly in quantity and quality activities conducted by Hulcher, not First National. The court therefore finds that First National's ownership of equipment located in Indiana is an activity that is not more than minimal, but is remote and incidental to the lease transaction from which its income is derived. Ownership alone is therefore not the degree of activity contemplated by the Indiana gross income tax statute.

Id., at 645

Taxpayer believes that since it was not involved in the day to day operations of the Indiana cable operations, it holds the same position as First National in First National Leasing.

Taxpayer's position is not the same as First National. First National's income arose from leasing activities over which it had no control. First National's contact with Indiana was not by its own action, but rather by action taken by its lessee. In the instant case, taxpayer's income arises from partnership distributions. Taxpayer's contact with Indiana was entirely by its own action. Taxpayer knew that the partnership's activities were conducted solely within Indiana. The decision in First National Leasing does not support taxpayer's position.

Next, the Department refers to 45 IAC 1.1-2-13, which states in relevant part:

> (a) As used in this section, "partner's distributive share" means the amount determined under Section 704 of the Internal Revenue Code and its prescribed regulations before any modifications required by Indiana tax statutes.
> (b) An amount credited to a corporate partner as its distributive share of partnership income, which is derived from sources within Indiana is subject to the gross income tax. An amount previously subjected to the gross income tax because it was included in the partner's distributive share but not actually distributed is not subject to the gross income tax again when it is actually distributed.
> …

The Department assessed gross income tax on taxpayer's distributive share of partnership income derived from sources within Indiana. This is in accordance with 45 IAC 1.1-2-13(b).

In conclusion, the Indiana tax court's decision in First National Leasing does not support taxpayer's position. Taxpayer is a limited partner as defined in Black's Law Dictionary. The Department properly followed 45 IAC 1.1-2-13(b)(7) in determining that taxpayer had a business situs in Indiana. The Department properly assessed gross income tax on taxpayer's distributive share of partnership income derived from sources within Indiana under 45 IAC 1.1-2-13.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Non-Filing Penalty

DISCUSSION

Taxpayer protests the imposition of a twenty percent (20%) non-filing penalty. Taxpayer states that it acted reasonably and that it did not believe that it was required to file a return. The Department imposed the penalty pursuant to IC 6-8.1-10-3(b), which states:

> If the department prepares a person's return under this section, the person is subject to a penalty of twenty percent (20%) of the unpaid tax. In the absence of fraud, the penalty imposed under this section is in place of and not in addition to the penalties imposed under any other section.

Since the Department prepared taxpayer's return, it imposed the penalty. The only requirements for this penalty are a taxpayer's failure to file a return and the preparation of a return for a taxpayer by the Department. Both of those conditions have been met in this case, therefore the penalty was properly imposed.

FINDING

Taxpayer's protest is denied.

WL/JM 052909